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COUNCILMEMBER  
DONNA FRYE

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Corporation

Memorandum

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Date: June 11, 2007

To: Council President and Members of the City Council

From: Carolyn Y. Smith, President *CYS*

**Subject: Response to Councilmember Donna Frye's Second Memorandum Dated  
May 22, 2007 – Issuance of SEDC's 2007 Tax Allocation Bonds**

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This memorandum is in response to the second memorandum prepared by Councilmember Donna Frye dated May 22, 2007 regarding SEDC's proposed 2007 Tax Allocation Bond (TAB) Issuance. It should be noted that seven of the questions listed below were previously addressed in our memorandum dated May 24, 2007 to the City Council in response to Councilmember Frye's May 14, 2007 memorandum and have been repeated and updated as necessary in this response.

**1. When was the last fiscal year that SEDC and the Redevelopment Agency had an audited financial report, and who issued the independent auditor's opinion?**

SEDC's corporate audited financial report was issued for the fiscal years ended June 30, 2006 and 2005 and the independent auditor's opinion was issued by Macias Gini & O'Connell LLP (Macias) on August 28, 2006. For the fiscal years ended June 30, 2005 and 2004, the opinion was also issued by Macias dated October 28, 2005.

Additionally, the audited financial reports for fiscal years ended June 30, 2004, as well as for the year ended June 30, 2003, were completed and the independent auditor's opinion were issued by Caporicci & Larson Certified Public Accountants.

The Financial Results of all projects of the Redevelopment Agency of the City of San Diego, as a blended component unit of the City, are included in the City's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2003, which was received and filed by the City Council on June 5, 2007. It is SEDC's understanding that Macias has been retained to perform an audit and render an opinion on the financial statements of the City for the fiscal years ended June 30, 2004 through June 30, 2007. Additionally, a separately audited Redevelopment Agency "stand alone" financial statement for the fiscal year ending June 30, 2003 has been completed by Macias, Gini & O'Connell LLP. The opinion was issued on this audit on June 4, 2007 and we have been advised by the City Comptroller that the report will be provided to the City Council shortly.

**2. Given the fact that there are no audited financial reports, what specific procedures were followed to ensure that the financial information is accurate and not misleading?**

The majority of the disclosure information contained in the Preliminary Official Statement is based on the Report of the Fiscal Consultant and is not of the type of financial information that is audited by an independent auditor. The following table is a list of the financial information and how it was obtained.

| Financial Information   | Procedures:   |
|---|---|
| Amount of Mount Hope Bonds to remain Outstanding after issuance of 2007 Bonds   | Following discussion with the members of the Financing Team, it was determined that the computed amounts would be based RBC Dain Rauscher (Managing Underwriter) computed these amounts based on upon the refunded amount of what is expected to be refunded and how much principal has been paid off over the years, as indicated in Official Statements for the outstanding bonds |
| Table 1- Tax Increment Received to Date   | Taken from Statement of Indebtedness filed for the 2006-07 fiscal year (required to be filed by Redevelopment Law). The Statement of Indebtedness was prepared signed by: Lawrence Tomanek, Assistant Auditor and Comptroller   |
| Statutory Pass-Through Payment Amounts for Fiscal Year 2006-0607  | Estimated by Fiscal Consultant based on Assessed Value (provided by the County) in Redevelopment Project Area and a statutory formula   |
| Pass-Through Agreement payments   | Estimated by Fiscal Consultant based on Assessed Value (provided by the County) in Redevelopment Project Area and formula set forth in appropriate agreement  |
| Redevelopment Law Section 33676 Payments  | Estimated by Fiscal Consultant based on 2005-06 amount provided by County, and increased by 2% projected growth each future year  |
| Outstanding City Loan Amounts payable from tax increment generated by Southcrest, Central Imperial and Mount Hope Redevelopment Project Areas | City Auditor's office Redevelopment Agency Accounting Section of the Comptroller's Office   |

3. ***What financial internal controls are in place at SEDC, the Redevelopment Agency, and the City of San Diego to ensure that the financial information being provided in the POS can be relied upon?***

At SEDC's corporate level, financial internal controls are in place and are reviewed and updated annually and in compliance with the independent auditors and the City Auditor & Comptroller's Office recommendations/requirements. However, this information is not necessary in connection with the offer and sale of the bonds. Please refer to our response to question number two (2) regarding the financial information reflected in the POS.

4. ***Much of the Information on page 6 of the POS (Certain Investigations Regarding the City) is outdated.***

This information has been updated in the current version of the POS that was delivered to the City Council the week of May 30<sup>th</sup>.

5. ***There are many blank pages and/or incomplete information on pages throughout the documents provided to the City Council for review. Please provide an explanation for all such pages and also when the missing information will be provided.***

Included in the 1472 for the Approval of the 2007 Tax Allocation Bond issuance provided to the City Council is an individual Log of Outstanding Items. The logs are inserted in front of each required document to be approved by the Agency and reflect the following information: Document Name; Page No.; Outstanding Items descriptions; Responsible Party; and Expected Availability.

6. ***Is the City Attorney's investigation of SEDC disclosed? What corrective actions has SEDC taken to ensure such problems do not occur in the future? Have the issues pointed out in the report been corrected?***

No. In response to the question raised by Mr. Levin during the meeting of the Disclosure Practice Working Group (DPWG) on April 26, 2007 regarding the disclosure of the City Attorney's investigation of SEDC, it was discussed and determined that the investigation and events described therein were not the type of information traditionally provided to potential investors. This determination was based upon the fact that the investigation found that SEDC had failed to comply with the City's affordable housing guidelines in only a few limited instances, and that the overall Redevelopment Agency affordable housing program required additional and better controls to eliminate the possibility of these situations occurring in the future. Moreover, one of the suggested controls has already been formally implemented by SEDC - the Housing Commission now monitors the Redevelopment Agency's compliance with the City's affordable housing guidelines.

Nothing in the investigation, or disclosed by the Independent Auditor's 2003 Report addressed to the Agency Board of Directors issued by Macias Gini & O'Connell LLP dated May 24, 2007, indicated that SEDC had any operational or other issues that would significantly impair its ability to

effectively manage the overall development of its project areas. Likewise, the subject investigation did not suggest or raise any issues that may materially affect the generation of tax increment in the Redevelopment Project Areas. Since the continuing operation of SEDC and the Agency's ability to collect tax increment in the Redevelopment Project Areas was not determined to be a material risk to the bonds, the recommendation was to exclude any description of or reference to the investigation in the POS.

7. ***The IBA's Report Number 07-51 also indicates that the Redevelopment Agency met with Moody's Ratings recently, and expects to receive a rating by May 18, 2007. the City Council should have that information before voting on this bond issuance.***

This bond issuance has received AA insurance from Radian Asset Assurance, Inc. and a Baa<sup>2</sup> rating from Moody's.

8. ***How much is the Southcrest Redevelopment Project Area proposing to borrow? How much is the Central Imperial Redevelopment Project Area proposing to borrow? How much is the Mount Hope Redevelopment Project Area proposing to borrow? Please include both principal and interest for each project area as well as the cost of issuing the bonds and funding the debt service reserve surety bonds for the Bonds.***

The schedule below summarizes our responses to your questions.

| <b>Amounts Proposing to be Borrowed by Project Area</b> |              |                   |                             |   |
|---|--------------|-------------------|-----------------------------|---|
|   | <b>Par *</b> | <b>Interest *</b> | <b>Total Debt Service *</b> | <b>Costs of Issuance * <sup>1</sup></b> |
| Southcrest  | 17,185,000   | 12,541,238        | 29,726,238                  | 2,007,624                               |
| Central Imperial  | 14,925,000   | 14,267,122        | 29,192,122                  | 1,651,705                               |
| Mount Hope  | 3,070,000    | 1,208,439         | 4,278,439                   | 297,078                                 |

1) Costs of issuance include underwriter's discount, cash deposit to Debt Service Reserve Fund, and Agency legal, ratings, trustee, printing, and consulting fees.

Note: Surety bonds will not initially be used to satisfy the reserve requirement. The reserve requirement will be met using cash from bond proceeds. This amount is included in Costs of Issuance.

\*Preliminary, subject to change. Based on interest rates as of 4/24/07

9. ***Please indicate where in the documents Appendix A can be found?***

This information has been updated in the most recent version of the POS that is included as Attachment A to this document.

**10. Please indicate where in the documents Appendices C, E and G can be found.**

Appendix C, the summary of Indentures and the Loan Agreements, are typically prepared after an insurer is selected and closer to the mailing date of the POS. The material provisions of the Indentures and the Loan Agreements have been summarized in the forepart of the POS. Appendix E, Form of Bond Counsel Opinion, has been added to the POS. Appendix G cannot be added until an insurer is selected and provides SEDC with the proper form.

**11. This information needs to be disclosed and should include SEDC's debt repayment schedule to the Redevelopment Agency as well as the funding source for the loan repayments. In Addition, please provide the loan repayment schedule for all debt owed to the City of San Diego by the Redevelopment Agency.**

As of June 30, 2006, the total amount of debt SEDC owes to the City of San Diego is \$71,698,973 which consists of \$38,429,442 in principal and \$33,269,531 of interest accrued. This information will be disclosed in the POS under the heading "Subordinate Obligations".

**12. Please provide the amount of the SEDC operating subsidy that the Redevelopment Agency has provided since SEDC's inception. What is the amount of the SEDC operating subsidy in 2007 and the source of revenue for that subsidy? Also, please provide the amount of proposed SEDC operating subsidy that the Redevelopment Agency may provide for FY 2008, and the source of revenue.**

In Mr. Greg Levin's memorandum dated November 21, 2006, in response to Councilmember Donna Frye's request, information was provided regarding the reimbursement payments received by SEDC for five (5) fiscal years (FY 2002 through FY 2006) totaling \$7,776,400. This amount is consistent with the 5 -year financial records available and retained by SEDC.

Since 1992, SEDC has not received any operating subsidies from the City of San Diego. More correctly, SEDC receives monthly reimbursements (as opposed to "operating subsidies") from the Redevelopment Agency for administering redevelopment activities in the four project areas and one study area located within the SEDC's Sphere of Influence. These reimbursements are payment for services rendered by SEDC on the behalf of the Redevelopment Agency and are primarily funded by tax increment revenues generated by the four redevelopment project areas administered by SEDC. The approved administrative budget in FY 2007 for SEDC was \$1,923,900 and \$2,576,700 in FY 2008 which was approved by the Agency/City Council on May 15, 2007.

- 13. Does the operating subsidy require repayment to the source of the subsidy? If SEDC did not receive an Operating Subsidy, would this hinder in any way their ability to meet their loan repayment obligations to the Redevelopment Agency?**

No, the reimbursement payments (as noted and described above) do not require repayment. It should be noted that any debt incurred as a consequence of SEDC performing its redevelopment obligations on the behalf of the Redevelopment Agency is a debt of the Redevelopment Agency and not SEDC.

- 14. Should the Redevelopment Agency's financial statement and the total current Agency debt be disclosed in the POS?**

The Bonds are payable from tax increment, which is calculated based on the assessed values of the various Redevelopment Project Areas. Purchasers of the bonds will be evaluating the credit strength of the bonds based on the historical and projected assessed value of the redevelopment project areas, and not the general financial statements of the Agency. The critical information is in the Fiscal Consultant's Report. Further all debt payable from the respective Project Areas is described in the POS. The Agency's financial statements include information that is not traditionally included in the POS with these types of financing. For purposes of consistency, this information was purposely excluded.

- 15. Was anyone retained to independently verify either the factual or financial information contained in the POS? If so, who performed the independent verification and when?**

No independent verification was undertaken. However, the customary bond team consisting of: SEDC, the City Attorney's Office, Special Agency Counsel, the Financing Services department, the Financial Advisor, the Underwriters, Bond Counsel, Disclosure Counsel, and the Fiscal Consultant were all involved with the review of both the factual and financial information provided in the POS. In addition, much of the information contained in the POS was obtained from source information believed to be reliable, including the assessed valuation data that the Fiscal Consultant obtained from the County. Summaries of the Redevelopment Plans and the legal documents were based directly on information contained in such documents. The source of information for all tables is indicated in the POS.

- 16. Should the Tax Revenues already received be identified and deducted from the total Tax Revenue remaining for each Project Area (in order to determine the amount of Tax Increment Revenue that could be used for new debt to make the loan repayments to the Redevelopment Agency)?**

The tax increment already received for each Redevelopment Project Area is listed in Table 1 under "TAX ALLOCATION FINANCING AND LIMITATIONS ON TAX REVENUES - Plan Limitations".

17. ***Please provide a description and examples of the type of debt to which this paragraph is referring. For example, would Redevelopment Agency debt from City of San Diego loans meet these criteria? The paragraph also refers to debt from the Housing Fund. What is this?***

California Community Redevelopment Law requires 20% of the tax increment generated by a redevelopment project area to be deposited in the Agency's Housing Fund. Money in the Housing Fund may only be used for the preservation, maintenance, improvement and development of affordable housing. The Agency may incur debt and collect tax increment after the limitations set forth in the Redevelopment Plan if the Agency has not complied with certain affordable housing benchmarks.

18. ***How much is that loan (principal and interest) and how much tax increment revenue has been secured to pay the bonded indebtedness?***

Please note the schedule which summarizes our responses to your questions.

| <b>Southcrest Bonded Indebtedness</b>   |   |
|---|---|
|   | <b>Par Amount *</b>                             |
| <b>Existing Bonds</b>   |   |
| Series 1995   | 2,385,000 - to be refunded by 2007 Bonds        |
| Series 2000   | <u>1,620,000</u> - to be refunded by 2007 Bonds |
| Subtotal:   | 4,005,000                                       |
| <b>2007 Bonds</b>   |   |
| Series 1995 Refunding   | 2,505,000                                       |
| Series 2000 Refunding   | 1,790,000                                       |
| New Money   | <u>12,890,000</u>                               |
| Subtotal:   | 17,185,000                                      |
| - All outstanding debt in Southcrest will be refunded by the Series 2007 Bonds.   |   |
| - The only debt outstanding in the Southcrest Project Area after the issuance of the Series 2007 Bonds will be \$17,185,000 par amount of the Series 2007 Bonds.  |   |
| - The average annual debt service (including principal and interest) on the Southcrest 2007 Bonds is \$1,143,317, which represents approximately 70% of 2006-07 tax increment (after payment to taxing entities). |   |
| *Preliminary, subject to change. Based on interest rates as of 4/24/07.   |   |

19. ***Please provide the page number in the POS for that Plan of Finance.***

The Plan of Finance section is on page 3 of the copy of the POS which has been attached to this memorandum.

**20. How much is the loan (principal and interest) and how much tax increment revenue has been secured to pay the bonded indebtedness?**

SEDC's response to this question is summarized in the table below.

| <b>Central Imperial Bonded Indebtedness</b>   |   |
|---|---|
|   | <b>Par Amount *</b>                             |
| <b>Existing Bonds</b>   |   |
| Series 2000   | <u>3,100,000</u> - to be refunded by 2007 Bonds |
| Subtotal:   | 3,100,000                                       |
| <b>2007 Bonds</b>   |   |
| Series 2000 Refunding   | 3,460,000                                       |
| New Money   | <u>11,465,000</u>                               |
| Subtotal:   | 14,925,000                                      |
| <ul style="list-style-type: none"> <li>- All outstanding debt in Central Imperial will be refunded by the Series 2007 Bonds.</li> <li>- The only debt outstanding in Central Imperial after the issuance of the Series 2007 Bonds will be \$14,925,000 par amount of the Series 2007 Bonds.</li> <li>- The average annual debt service (including principal and interest) on the Central Imperial 2007 Bonds is \$941,681, which represents approximately 55% of 2006-07 tax increment (after payment to taxing entities).</li> </ul> |   |

\*Preliminary, subject to change. Based on interest rates as of 4/24/07.

**21. Please provide the page number in the POS for that Plan of Finance.**

The Plan of Finance section is on page 3 of the clean copy of the POS.

**22. Should there be a plan of finance for Mount Hope included in the POS?**

There is a Plan of Finance description for Mount Hope on page 3 of the POS. A cross reference to the "Plan of Finance" section has been added to the Outstanding Debt description for Mount Hope.

23. ***Please explain why the information provided in the Loan Agreement is different than the information provided in the POS? Has some of the debt been repaid?***

The following schedule summarizes SEDC's responses to your questions.

| <b>Central Imperial Bonded Indebtedness</b>  |  |
|--|--|
|  | <b>Par Amount *</b>                        |
| <b>Existing Bonds</b>  |  |
| Series 1995A   | 840,000 - will remain outstanding          |
| Series 1995B   | 3,085,000 - to be refunded by 2007 Bonds   |
| Series 2002A   | <u>3,055,000</u> - will remain outstanding |
| Subtotal:  | 6,980,000                                  |
| <b>2007 Bonds</b>  |  |
| Series 1995A   | 840,000                                    |
| Series 2002A   | 3,055,000                                  |
| Series 1995B Refunding   | <u>3,070,000</u>                           |
| Subtotal:  | 6,965,000                                  |
| <ul style="list-style-type: none"> <li>- The Mount Hope Series 1995B Bonds will be refunded by the Series 2007 Bonds.</li> <li>- The total debt outstanding in Mount Hope after the issuance of the Series 2007 Bonds will be \$6,965,000 par amount of the Series 1995A, 2002A, and 2007 Bonds.</li> <li>- The average annual debt service (including principal and interest) on the Mount Hope 1995A, 2002A, and 2007 Bonds is \$564,849, which represents approximately 44% of 2006-07 tax increment (after payment to taxing entities).</li> <li>- Par amounts listed in the POS are lower than those listed in the Loan Agreements due to repayment of principal over the years.</li> </ul> |  |

\*Preliminary, subject to change. Based on interest rates as of 4/24/07.

24. ***Would the debt owed to the Redevelopment Agency reduce the maximum amount of Tax Revenues that could be used by the Southcrest, Central Imperial or Mount Hope Project Areas to pay for new debt service? How is the debt to the Redevelopment Agency accounted for in SEDC's financial disclosures in the POS, and where is it shown?***

To clarify, the loans are between the Agency and the City and are payable from tax increment generated from the Project Areas administered by SEDC. To the extent this debt is paid from tax increment, the amount would count against the tax increment limitation for such Project Area. The debt to the City is described under "Outstanding Debt" in the description of each Project Area.

25. ***Is there any other debt that is owed by the SEDC Project Areas to the Redevelopment Agency or anyone else that is not disclosed and/or that may affect the Redevelopment Agency's ability to pay back the debt it owes to the PFFA, the City or anyone else?***

There are contracts listed in the Statement of Indebtedness for various services. The amount actually paid to the service provider may be less than the amount listed on the Statement of

Indebtedness depending on the degree to which the service provider was used. For the 2006-07, the amount of contracts is \$35,623 for Southcrest, \$24,257 for Mount Hope and \$413,946 for Central Imperial. The Central Imperial figure includes \$97,566 for legal services, \$64,168 for Planning and Design, \$53,395 for Project Improvements and \$195,375 for mitigation payments. These amounts are described under "Outstanding Debt" in the description of each Project Area, and are not expected to impact the Agency's ability to repay its debts.

26. ***In order to determine if the Debt Limit has been exceeded, would that amount be subtracted from the Debt Limit amount? Is this correct and has the Mount Hope Project Area exceeded their Debt Limit?***

The Debt Limitation in the Redevelopment Plans only limits the amount of bonded indebtedness that can be outstanding at any one time. The loans from the City to the Agency are not included in this limitation. Also, any debt that is repaid does not count against the limit (i.e. if there is a \$100 limit, \$60 in bonds are outstanding and \$40 is paid off, then Agency may borrow up to \$80 million). None of the Project Areas will exceed their bonded indebtedness limit as a result of the issuance of the Bonds.

27. ***Would the existing debt combined with the new debt cause the Debt Limit to be exceeded or does the Debt Limit amount that is shown include existing and/or new debt? If not, is it legal and shouldn't it be disclosed in the POS?***

Please see Response No. 26.

28. ***Would the existing debt combined with the new debt cause the Debt Limit to be exceeded or does the Debt Limit amount that is shown include existing and/or new debt? If not, is it legal and shouldn't it be disclosed in the POS?***

Please see Response No. 26.

CYS:kk

c: Mayor Jerry Sanders  
City Attorney Michael Aguirre  
Deputy City Attorney for Disclosure, Mark Blake  
Chief Financial Officer, Jay Goldstone